IN THE

# Supreme Court of the United States

October Term, 1964

No. 134

Paragon Jewel Coal Company, Inc., *Petitioner*

v.

Commissioner of Internal Revenue

On Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit

## REPLY BRIEF AS AMICUS CURIAE OF JEWELL RIDGE COAL CORPORATION IN SUPPORT OF PETITIONER

Jewell Ridge Coal Corporation

By Seymour S. Mintz
Robert K. Eifler
800 Colorado Building
Washington, D. C. 20005
*Attorneys for Jewell Ridge Coal Corporation*

Hogan & Hartson
800 Colorado Building
Washington, D. C. 20005
*Of Counsel*

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As *amicus curiae*, Jewell Ridge confines this reply to answering arguments of respondent Robert Lee Merritt[1] in opposition to points made in Jewell Ridge's opening brief.

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[1] References herein to "Merritt" are to respondents Robert Lee Merritt et al. in No. 237, which is consolidated with No. 134. References to "R. Br." are to the brief for respondents in No. 237, and references to "J.R. Br." are to Jewell Ridge's opening brief as amicus curiae.

## 1. LEGAL CONTROL OF THE COAL DEPOSIT REMAINED IN PARAGON

The coal mine operators concede, as they must, that before entering into the oral contracts here in question Paragon, as lessee of the coal deposit, held the sole right to reduce the coal to possession and ownership (R. Br. 45). The operators also concede that under the contracts they were required to deliver all coal they mined to Paragon (R. Br. 28-29, 31). Nevertheless, the operators contend that, once the oral agreements were made, they, not Paragon, held legal control of the coal deposit. This is made plain by respondents' statement that (R. Br. 45):

> "Before entering into agreements with the operators Paragon . . . held the right to mine the coal and reduce it to possession and ownership. After these agreements it held the right to acquire and sell it only. The operators held the right to mine the coal, reduce it to possession and be paid in accordance with the market."

Whether the operators acquired legal control of the coal deposit is critical, since if they did not their claim to a depletion deduction must fall (J.R. Br. 13, 16-17, 27).

At one point respondents state that under the oral contracts Paragon could acquire the coal "if it so elected" (R. Br. 45). But elsewhere they concede that coal properly refused by Paragon could not be taken elsewhere by the operators (R. Br. 25, 28-29, 31). In the final analysis, the operators' position that they had legal control of the coal deposit is founded upon an alleged oral agreement by Paragon that it would accept and pay for all marketable coal produced by the operators (R. Br. 29, 31). To support this position

the operators cite (R. Br. 29) a portion of Clyborne's testimony to the effect that, to the best of his knowledge, Paragon had always taken all the marketable coal which the operators mined (R. 54).

It is true that during the years here involved Paragon did take all the marketable coal produced by the contractors operating on Paragon's leased property (R. 216). But that does not necessarily indicate that there was an agreement or understanding that Paragon would take all such coal. It is equally consistent to infer that the contract mine operators produced no more coal than Paragon desired from time to time. Further, this is the logical inference since, as is said in the operator's brief, they could not produce and sell coal without Paragon (R. Br. 18). This was true because the raw coal the operators mined was not salable on the market, but had to be washed, graded and treated to be salable (R. 216), and Paragon alone had the right to apply the ordinary treatment processes necessary to obtain the marketable product.[2] Hence the reasonable inference is that, needing Paragon's

[2] The operators' statements in their brief that (if Paragon refused to accept and pay for the coal they mined) it would have been possible for them to sell the raw coal to other coal companies in the area (R. Br. 31) and that there is a "price" for such coal (R. Br. 26, 32) are unsupported in the record and open to question. Jewell Ridge will not accept such "bootleg" coal, and it understands that other coal companies in the area will not do so, since it could not be known whether the lease royalties and United Mine Workers benefits had been paid in respect of such coal (so that the company accepting such coal might become liable to the United Mine Workers Welfare Fund as well as to the lessor or the lessee, or both). In the present case Paragon's contract mine operators undertook no obligation to pay lease royalties (R. 214) and contend that they had no obligation for payments to the United Mine Workers Welfare Fund (R. Br. 26). Hence it is doubtful that they could have sold the coal elsewhere.

treatment (and sales) facilities to process (and sell) the coal, the operators would gear their mining operations to Paragon's desires for raw coal. Moreover, a witness for Paragon testified that when Paragon's coal treatment plant was closed, sometimes for as long as a week, the operators could fill their mine cars and bins, but then were required to shut down until Paragon was ready to take more coal (R. 99; cf. R. 130). And the Tax Court found this to be the fact (R. 216). All these recited facts of record are inconsistent with respondents' assertion that Paragon agreed to accept and pay for all marketable coal produced by the operators (R. Br. 29, 31). Instead such facts, taken together with the admitted facts that Paragon was the sole lessee of the coal lands and the operators were required to deliver all coal to Paragon, confirm that under the oral contracts legal control of the coal deposit remained in Paragon (J.R. Br. 15-16). This factor, even if it stood alone, is sufficient to defeat the operators' claim (J.R. Br. 16-17).

## 2. THE CONTRACTOR HAD NO FIXED OR DETERMINABLE RIGHT TO SHARE IN THE VALUE OF THE COAL

Even were it true (as it is not) that Paragon was bound to accept all marketable coal the operators produced, Paragon was not obligated to pay a fixed or determinable price for the coal. Most, perhaps all, of the evidence of record in this respect is cited and reviewed in Jewell Ridge's brief (pp. 19-21). Nevertheless, referring to a few isolated portions of the record (R. Br. 26) and relying heavily on a graph allegedly showing a direct relationship between the amount Paragon paid operators and the Bituminous Coal Index (R. Br. 29-30, 49), the operators repeatedly assert that whenever there was a substantial or signifi-

cant change in the market price of coal, either up or down, the operators expected and received a corresponding increase or decrease (R. Br. 25, 27, 30), that this was the agreement to which the parties adhered (R. Br. 25, 26, 27, 31, 32), that the market price was the controlling factor (R. Br. 26) and that the operators were required to look beyond Paragon to the market price of coal for the return of their investments (R. Br. 27).

The issue on this point is, therefore, clear. The operators contend that there was a direct and legally enforceable contractual linkage between the value of the coal extracted and the amount to which they were entitled. The Tax Court found to the contrary (R. 222). And this finding was not contradicted by the Court of Appeals (see R. 254, lines 13-15 and R. 255, lines 27-29). Moreover, the operators' contention is refuted, not only by the evidence of record recited in Jewell Ridge's opening brief (pp. 19-20), but also by the very comparison of Exhibits 74 and 98 on which respondents so heavily rely, as will now be shown.

First, in February 1952 there was a 12.5% increase, from $4.00 to $4.50 per ton, in the amount paid operators (R. 230), even though the market price of bituminous coal had remained steady as a rock (varying only one or two percentage points from month to month and but fractions of a point from year to year) since December 1949 (R. 250-251). Respondents attempt to explain away the February 1952 change in the operators' compensation as a "negotiated increase" (R. Br. 29) and they omit it from their graph (R. Br. 49). But respondents' witness explained the change as an increase requested by the contractors and granted by Paragon to cover the contractors' costs of opera-

tions (R. 119). Hence the first change was inconsistent with the alleged agreement that "the market price was the controlling factor" (R. Br. 26).

Second, the market price of bituminous coal dropped 3% in April 1952 (equal to a 13½ cents decrease in the operators' then \$4.50 piecework rate). This coal price drop, the first one so large in two years, continued through May and June into July and August and was not entirely erased until October, 1952 (R. 250). Nevertheless, the operators' \$4.50 piecework rate was not decreased, but remained constant throughout this entire period (R. 230). Like the February 1952 piecework rate increase, respondents omit the April 1952 coal price drop from their graph (R. Br. 49), perhaps on the ground that it was not "significant". But it seems clear that they would have thought significant a 13½ cents decrease in their rate of compensation (R. 142, 169). Hence the second change was inconsistent with the alleged agreement that "the operators were required to look beyond Paragon to the market price of coal for the return of their investments" (R. Br. 27).

Third, the record indicates that the operators were notified at least two or three days in advance of any increases or decreases in their rate of compensation (R. 87, 93, 105). In any event, no later than October 1, 1952, Paragon increased the operators' rate to \$4.75 (R. 230). Respondents' witness testified that this increase was due to a rise in the costs of labor (R. 119). And this seems likely, since the increase preceded, and did not follow, the price rise which occurred in October 1952 (R. 250) after the costs of labor had gone up in the coal fields (R. 119). Moreover, the October 1, 1952 increase in the operators' rate occurred either

before or just as coal prices recovered from the aforementioned April 1952 price drop (R. 250). Hence it seems unlikely that the increase could have been thought of as compelled by a coal price rise. All these facts tend to confirm the testimony of respondents' witness that the October 1, 1952 increase in the operators' rate, like the February 1952 increase, was made to cover the operators' costs. Hence it is clear that the third change, like the two (discussed above) which preceded it, was inconsisent with the operators' present contention that their compensation "was dependent upon the market price of coal" (R. Br. 25).

Enough has been said above to show that the asserted oral agreement, allegedly linking the operators' rate to the market price of coal, simply did not exist. But at the risk of belaboring the point, since respondents so strenuously and persistently insist to the contrary and their case depends on it, perhaps a few additional inconsistencies between the evidence of record and the alleged oral agreement should be noticed.

From October 1952 through March 1953, the bituminous coal index gradually climbed from about 110 to about 112 in January and then subsided to about 110 again in March (R. 249, 250), without any increase in the operators' rate (R. 230). Nevertheless, no later than March 1, 1953 (R. 230) and probably a week or so before then (R. 87, 93, 105) and at least a full month before the April 1953 drop in the market price of coal (R. 249), Paragon cut the operators back to \$4.50 per ton (R. 230). Respondents' witness attempted to explain this decrease as: "they told us that the price of coal went down and they would be forced to cut the price in order to run" (R. 119). But the operators also say that they "are as knowledgeable as to changes

in coal prices, as little leaguers are to the batting average of Mickey Mantle" (R. Br. [illegible]). If so, they knew that the market price of coal had *not* gone down. And if there were such an agreement as they now alleged, they not only would have objected strenuously (R. 142, 169) but, according to their brief, they would have taken legal action (R. Br. 9, fn. 5). They did neither (R. 119, 142). Like any operators "compelled to take less", they "grumbled and complained, but they made no issue of the decreases" (R. Br. 25). For "as far as they were concerned, Paragon was living up to its bargain with them in every respect" (R. Br. 9, fn. 5).

The foregoing recitations from the record show that the March 1, 1953 decrease in the operators' rate, like all the other changes which preceded it, cannot with logic or consistence be reconciled to the operators' present allegation that their rate of compensation was contractually linked to the market price of coal. Instead these facts of record, like others cited and reviewed in Jewell Ridge's opening brief (p. 2[illegible]) confirm the Tax Court's conclusion that the operators "had no knowledge or interest in the price that Paragon received from the sale of the coal" (R. 222).

Near the beginning of January, 1954 (R. 230), after the price of coal had been stable for nine months (R. 249), and at least two months before the March, 1954 drop in bituminous coal prices (R. 249), Paragon again cut the operators' rate, this time to $4.25 (R. 230). Just like the March 1, 1953 change, discussed immediately above, the January 1954 change was fatally inconsistent with the operators' present alleged view of the oral contract and fully consistent with Jewell Ridge's view (J.R. Br. 19-21).

Near the end of March, 1954, when the Bituminous Coal Index fell to 102.5, the lowest point in nearly six years (R. 249-251), Paragon further reduced the operators' rate to \$4.00, the same rate they were paid in 1951 and early 1952 (R. 230). But in April, 1955, when the Bituminous Coal Index plummeted to near 98, and remained near there through May, June, July and August (R. 249), Paragon did *not* decrease the amount paid its operators (R. 230). Rather, at the end of August, 1955, in which month the Bituminous Coal Index hovered at 99.7 (R. 249), Paragon *increased* the operators' rate to \$4.25 (R. 230). The April 1955 drop in the coal market (like the April 1952 drop mentioned above), is not reflected on respondents' graph (R. Br. 49). The reasons for these omissions are not explained in respondents' brief.

Respondents' say that there was no evidence that any of the changes made by Paragon in the operators' rate reflected changes in the operators' labor costs (R. Br. 26). But respondents' own witness, G. W. Merritt, testified that: "most of the time, when the union would get an increase, why we generally got an increase there" (R. 147).

The cumulative effect of the facts of record recited herein demonstrate that respondents' position will not bear close analysis. (A) The February 1952 and October 1, 1952 increases in the operators' rate to cover their costs, without at the time there having been any substantial coal price rise, (B) the April 1952 and April 1955 failures of Paragon to cut the operators' rate despite sharp, substantial and prolonged coal price drops, (C) the March 1, 1953 and January 5, 1954 cuts of the operators' rate during periods of good coal prices and substantially in advance of any coal price

drop, and (D) the increase in the operators' rate at the end of August, 1955, when coal prices were at their lowest ebb, all these combine with the facts of record cited and summarized in Jewell Ridge's opening brief (pp. 19-20) to support and confirm the Tax Court's uncontradicted conclusion (R. 222) that there was no direct or indirect contractual or other legal linkage between the value of the coal which the operators extracted and the amount of compensation to which they were entitled. This then is a second essential test the operators have failed to meet (J.R. Br. 21-23).

3. EVEN IF ALL THE CONTRACTORS' CONTENTIONS WERE CORRECT, THE INTERESTS THEY CLAIMED WERE NOT DEPLETABLE

Apparently respondents would prefer to forget that, even if all their contentions were correct, an operator's income did not depend solely on the coal he extracted from the deposit in which he claimed an interest. Nevertheless, the point is important. And respondents have not answered it.

The source of an operator's income, insofar as it actually came from coal,[3] was all the coal mined from Paragon's leasehold, and not the coal mined by the operator. For this reason also, the interests claimed were not depletable (J.R. Br. 24-26).

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[3] Since amounts due contractors were payable by Paragon whether it gained or lost on sale of the coal (R. 128, 214), such amounts were payable from Paragon's borrowed or equity capital (R. 216), so that coal proceeds was not the sole source of an operator's income, despite respondents' statement to the contrary (R. Br. 30).

## 4. INTEREST OF AMICUS CURIAE

In respect of No. 262, respondents assert that a statement by Jewell Ridge (as to an understanding that it could, as it did, control the amount of coal its operators were from time to time permitted to mine) was "simply not true" (R. Br. 47). In support of this assertion, respondents try to rely (R. Br. 47) on the Tax Court's decision in *Norman E. Clifton*, T.C. Memo. 1958-65, CCH Dec. 22, 936 (M), for the proposition that: "Jewell Ridge agreed to accept all coal produced by petitioner [contract mine operator] and there was no limitation on the amount of coal petitioner could produce." The reliance is misplaced.

*Clifton* was a different case on a different record than *Commissioner* v. *Raymond E. Cooper*, et al., No. 262, this Term. In considering the record in *Cooper*, the Tax Court was well aware of its earlier findings and opinion in *Clifton*. Yet with all the testimony and exhibits of the earlier case and two additional volumes of testimony in the later case both directly[4] before it, and though expressly requested to do so by respondents, the Tax Court in *Cooper* refused and omitted to make the very finding upon which respondents now attempt to rely.

In the *Cooper* case, all the testimony on this point (of contract mine operators Cooper, Smith, Clifton, Harris, Sheets and McFall and of Jewell Ridge's employees Bunton, Youell and McBurney) was to the

[4] On motion by respondents Raymond E. Cooper, et al., the testimony and exhibits in the *Clifton* case were received in evidence in the *Cooper* case.

same effect.[5] The questions asked by the Government's counsel and Bunton's answers will suffice as a sample:

> "Q. During 1953 . . . through July, 1958, did Jewell Ridge exercise any control over production of these truck mines?
> A. Yes, sir.
> Q. How did they do it?
> A. By whether or not they operated the tipple.[6]
> Q. What would they do?
> A. We would just close the tipple down and put out the sign there was no work. And when we got ready to go back to work we would post another sign—a work sign. Those were posted in the pay roll offices at the Jewell Ridge Coal Corporation" (Tr. 229).

Hence it is true that in No. 262, despite respondents' statement to the contrary (R. Br. 47), there was an express understanding between Jewell Ridge and its contract mine operators that Jewell Ridge could, as it did, maintain complete, unilateral control over the amount of coal which its contract mine operators were from time to time permitted to mine. For this and other reasons mentioned in Jewell Ridge's opening brief, if the present case is reversed No. 262 should be also, whereas if the present case is affirmed the Commission's petition in No. 262 should be granted.

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[5] Transcript references in the *Cooper* case are pp. 73-74, 96, 119-120, 154-155, 177, 201, 229, 270-271, 303-304, all of which were cited to the Court of Appeals in the Commissioner's brief, p. 19.

[6] Within a few miles of each other in the same area of Virginia, Jewell Ridge operated three coal treatment plants, termed "tipples", one of which was used primarily to prepare coal mined by Jewell Ridge's contract mine operators.

## CONCLUSION

For the reasons stated herein and more fully developed in Jewell Ridge's opening brief, the judgment of the Court of Appeals, permitting depletion deductions to the contract mine operators, should be reversed and remanded for entry of an order affirming the Tax Court.

Respectfully submitted,

JEWELL RIDGE COAL CORPORATION

By SEYMOUR S. MINTZ
ROBERT K. EIFLER
800 Colorado Building
Washington, D. C. 20005
*Attorneys for Jewell Ridge Coal Corporation.*

HOGAN & HARTSON
800 Colorado Building
Washington, D. C. 20005
*Of Counsel*

February 1965.